Brown-Forman (BF-B)

Updated August 30th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$52	**5 Year CAGR Estimate:**	6.8%	**Volatility Percentile:**	43.0%
Fair Value Price:	$44	**5 Year Growth Estimate:**	8.8%	**Momentum Percentile:**	75.7%
% Fair Value:	117%	**5 Year Valuation Multiple Estimate:**	-3.2%	**Valuation Percentile:**	35.0%
Dividend Yield:	1.2%	**5 Year Price Target**	$67	**Total Return Percentile:**	40.8%

Overview & Current Events

Brown-Forman is an alcoholic beverages company that is based in Louisville. The company was founded in 1870 and has a market capitalization of $24.6 billion. Brown-Forman produces and sells whiskeys, vodka, tequila, champagne and wine. Its brands include Jack Daniel's, Finlandia Vodka, Old Forester and many more.

Brown-Forman reported its first quarter (fiscal 2019) results on August 29. During the fourth quarter the company earned $0.41 per share, representing an earnings per share growth rate of 12% year over year. The company was able to grow its revenues by 5.9% year over year. Brown-Forman's top line hit $770 million in the quarter.

Brown-Forman's outlook for 2019 is quite positive. Management expects sales growth of 6%-7% and sees earnings per share in a range of $1.65 to $1.75. These are GAAP numbers and represents 11%-18% growth over 2018's GAAP earnings per share. On an adjusted basis, Brown-Forman will likely earn about $1.80 per share during 2019.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	$0.82	$0.95	$0.95	$1.07	$1.22	$1.28	$1.38	$1.37	$1.65	$1.67	***$1.80***	***$2.74***
DPS	$0.31	$0.33	$0.36	$0.39	$0.44	$0.48	$0.52	$0.56	$0.59	$0.63	***$0.67***	***$0.97***
Shares	563M	551M	544M	533M	534M	534M	522M	494M	480M	481M	***475M***	***465M***

Brown-Forman has a strong growth track record. The company has been able to increase its profits even during the last financial crisis. During the 2012 to 2017 time frame, Brown-Forman grew its profits per share by an attractive 9% a year.

Underlying sales growth was stronger during Q1 than what Brown-Forman reported, due to currency headwinds. Brown-Forman's earnings growth has been based on revenue growth and some margin increases in the past. Thanks to the fact that Brown-Forman owns strong brands and is active in the super-and ultra-premium alcoholic beverages markets, which see consistent market growth, Brown-Forman should be able to keep its revenues growing going forward.

Brown-Forman's Jack Daniels brand as well as its American super-premium whiskeys showed strong growth during Q1. According to management, momentum will remain positive during fiscal 2019. International operations were the main growth driver during the most recent quarter and will likely remain so going forward.

Higher overall sales allow for margin increases due to better economics of scale, which makes the company more efficient overall. Share repurchases, which have lowered Brown-Forman's share count considerably over the last decade, have had a positive impact on the company's earnings per share growth as well. Brown-Forman has recently announced a new $200 million share repurchase program.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	16.1	17.9	21.4	24.1	24.7	28.4	28.8	27.6	33.2	32.0	***28.9***	***24.6***
Avg. Yld.	2.4%	1.9%	1.8%	1.5%	1.4%	1.3%	1.3%	1.5%	1.1%	1.1%	***1.2%***	***1.4%***

Shares of Brown-Forman were never trading at an especially cheap valuation, but over the last couple of years the company's multiples rose to an even higher level. Right now shares are valued at almost 30 times 2019's earnings.

This is a premium over the long-term median, which is why we forecast some multiple contraction going forward. Brown-Forman does not pay out a high quarterly dividend yield, but it makes special dividend payments regularly. Including its most recent special dividend payment of $1.00 per share its trailing dividend yield is 3.0%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
GP/A	45.4%	47.6%	46.4%	51.7%	54.0%	50.7%	52.0%	51.2%	43.6%	44.2%	***44.7%***	***45.0%***
Debt/A	47.7%	44.1%	44.5%	40.5%	55.1%	50.5%	54.4%	62.7%	70.4%	73.5%	***75.0%***	***80.0%***
Int. Cov.	21.5	25.5	33.0	28.3	27.3	40.5	41.1	34.9	17.7	11.9	***11.0***	***10.0***
Payout	37.8%	34.7%	37.9%	36.4%	36.1%	37.5%	37.7%	40.9%	35.8%	37.7%	***37.2%***	***35.3%***
Std. Dev.	29.5%	20.5%	26.2%	16.6%	16.6%	16.5%	18.1%	18.6%	20.1%	21.1%	***20.0%***	***19.0%***

Brown-Forman has leveraged up over the last decade, financing close to three quarters of its assets with debt. The company is in no way overleveraged, though, as the interest coverage ratio remains quite high. Brown-Forman has taken advantage of the very low interest rates over the last couple of years, which is an intelligent and opportunistic move.

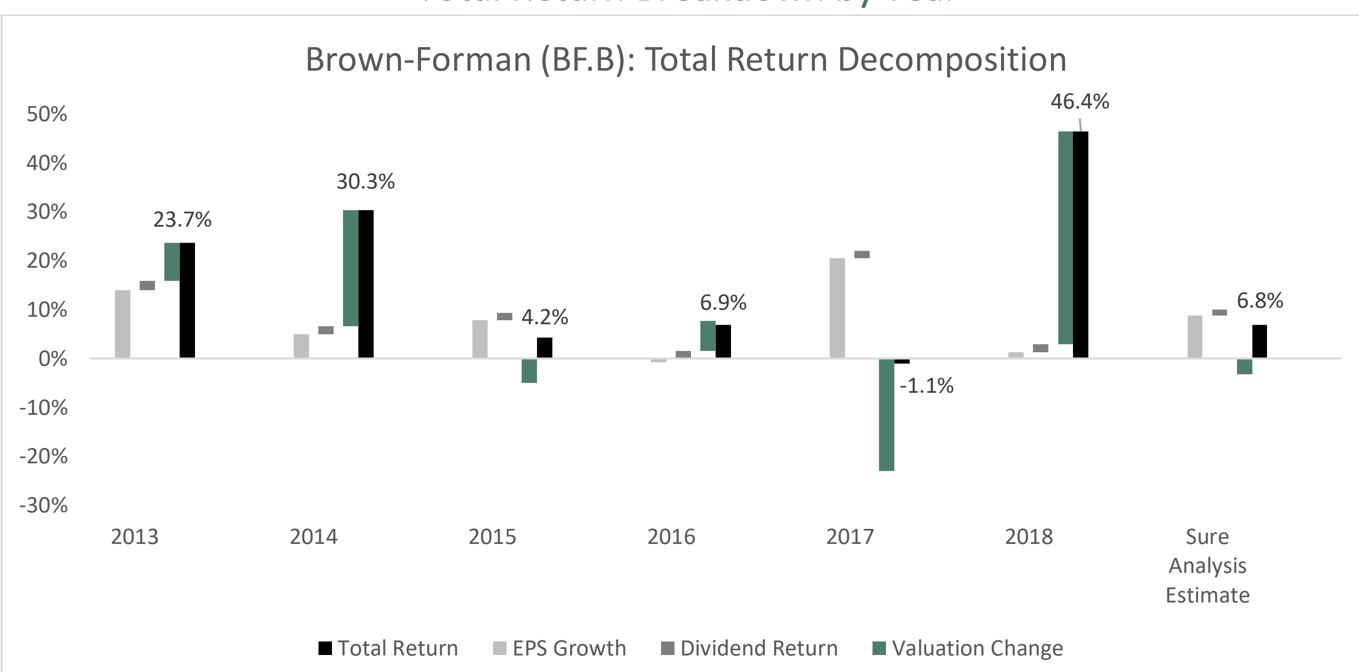
Brown-Forman's strong brands and the tendency of customers to stick with the brands they like is a tremendous competitive advantage. This, along with the fact that Brown-Forman is one of the largest players in its industry, which allows for better economics of scale and a wider geographic reach.

During the last financial crisis Brown-Forman remained highly profitable and actually increased its earnings, which is unsurprising as demand for alcohol tends to be consistent. Brown-Forman should be able to weather recessions well.

Final Thoughts & Recommendation

Brown-Forman is a high-quality company with strong fundamentals, a great track record and Dividend Aristocrat status. Earnings growth over the coming years should be solid, but the high valuation will be a headwind for Brown-Forman's total returns over the coming five years. We think that Brown-Forman operates a great business, but due to the high valuation the stock does not look like a buy today. At or below fair value Brown-Forman would be a compelling buy for investors seeking total returns. It earns a hold recommendation today.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.